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Central America at a Crossroads

Sylvia Saborio
and
Constantine Michalopoulos

Steps the Central American governments must take for fuller integration into the international economy.

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In the last few years, the countries of Central America have taken steps to stabilize their economies and to introduce domestic and trade reform aimed at improving resource allocation and making domestic markets more competitive. As the Central American governments move toward integrating their economies into the world market, Saborio and Michalopoulos suggest that they:

• Continue to participate fully in the multilateral round of trade negotiations, because as small, open economies they have a great stake in the health of the international trading system.

• Revitalize the Central American Common Market, not as a sheltered regional market for inefficient domestic firms but as an expanded base for regional competitiveness and for coordinating policy with the rest of the world.

• Seek preferential trade arrangements with the United States and possibly other countries in the context of the Enterprise for the Americas Initiative (EAI), if it serves the larger purpose of liberalizing trade — but be leery of partial, isolated agreements that may divert more trade than they create.

Mexico's entry into the North American Free Trade Area (NAFTA) could seriously harm Central American interests by diverting trade and investment from the region. To temporarily protect the Central American countries from the unintended fallout of Mexico's entry into NAFTA, Saborio and Michalopoulos recommend the adoption of an interim provision that would extend to Central America any preferences the U.S. grants to others (beyond those already provided by the Caribbean Basin Initiative). Such a provision, effective between now and, say, 1995, would provide a mechanism for the transition from unilateralism to some type of reciprocity in U.S. commercial relations with these countries. During this period, the countries of Central America would continue to undertake the necessary economic and institutional reforms to enable them to meet international competition more effectively.

While Central America should do all it can to get greater, preferential, and more secure access for its products — particularly in the main, most dynamic market for its nontraditional exports — it must recognize that current obstacles to export growth are related not only to external market opportunities, but also to internal problems that inhibit export supply.

Central America at a Crossroads

by
Sylvia Saborio
and
Constantine Michalopoulos*

Table of Contents

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CENTRAL AMERICA AT A CROSSROADS

I. INTRODUCTION

Like elsewhere in Latin America, profound changes in economic thinking and praxis are taking place in Central America today. Having just emerged from a long period of strife and decline, Central America seems determined not to let the momentous changes happening around it and in the world at large pass it by. At the same time, though, uncertainties surrounding the evolution of the international environment, apprehensions about increased vulnerability to external events, and the misgivings of some about abandoning the sheltered existence of the past, are inhibiting more decisive reforms.

This paper considers the challenges and opportunities facing the Central American countries and explores the choices open to them for fuller integration into the world economy. The paper is structured as follows: Section II presents a brief historical account of the origins and evolution of the Central American Common Market (CACM) and its near demise in the 1980s and highlights the thrust of these countries' trade and payments policies over the past decade. Section III presents an overview of the pattern and trends in Central America's trade relations within the region and with the rest of the world, examines prevailing access conditions for the region's exports in the main industrial country markets and explores the ways in which three major developments in the international economy --the Uruguay Round, EC-92 and the North American Free Trade Agreement-- are likely to affect Central America's economic interests. Section IV analyses the options open to the region as it seeks greater integration into the world economy and examines the domestic policy implications of such an outward-oriented development strategy. Finally, Section V contains the conclusions and policy recommendations of the paper.

II. CENTRAL AMERICA IN THE 1980s

A. Background

The establishment of the Central American Common Market (CACM) in 1960 had the dual purpose of fostering industrial development and reducing these countries' extreme dependence on the export of a handful of primary commodities, notably coffee and bananas, which constituted the bulk of their external sales. The CACM did indeed help spur industrial growth and intra-regional trade. The share of intra-regional in total trade rose from under 7.5% to 25% between 1960 and 1980, and it consisted mostly of manufactures previously imported from the rest of the world.

The pattern of industrialization that evolved, however, was essentially inward-looking, more local than regional in character.[1] Efforts to establish large scale industries to serve the regional market were largely unsuccessful because it was politically impossible to reach agreement on where such "strategic" units should be located. Industrial integration was also discouraged by the structure of the Common External Tariff (CET). By providing higher protection for consumer goods than for intermediate and capital goods, it fostered the establishment of assembly-type operations, that generated little local value-added and were highly dependent on imported inputs from the rest of the world. To make matters worse, because the highest tariffs in the schedule were levied on luxury goods to discourage superfluous consumption, it was precisely on those items (e.g. perfumes, cosmetics), where the greatest incentives for import substitution were unwittingly created.

The expansion of intra-regional trade, particularly in manufactures, did make CA's overall trade pattern more diverse. But because industry was import intensive and inward oriented, it became a net user of foreign exchange. As a result, industrial activity, employment and intra-regional trade became increasingly dependent on the foreign exchange generated by extra-regional exports. However, the same incentives that favored intra-regional trade discouraged the expansion and diversification of extra-regional exports, which continued to be dominated by coffee and bananas. Consequently, the development of the regional market not only did not insulate these countries from synchronous shifts in international terms of trade, but actually made economic activity in the region much more vulnerable to such disturbances.

In fact, the regional economy prospered as long as the international economic environment was relatively benign and there was enough foreign credit to bridge whatever fiscal or trade deficits developed without having to curtail imports from within or outside the region. When the external environment took a marked turn for the worse, as it did in the late 1970s, it unleashed a chain reaction that sent the regional economies on a tailspin.

B. Onset of the Crisis

The crisis that exploded in the region in the early 1980s was as much political as economic in nature, and national as well as regional in scope. While its underlying causes are old and complex, its immediate trigger can be traced to the sharp deterioration in the region's terms of trade, which coupled with the recession-induced decline in demand for its primary exports severely curtailed the purchasing power of the region's exports; and the unprecedented rise in international interest rates, which raised debt

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1/ Even in the heyday of the CACM (1970), fully 75% of industrial output was absorbed domestically and only 16% was sold elsewhere in the region. See Willmore, Larry "La Promocion de Exportaciones y la Sustitucion de Importaciones en la Industria Centroamericana", Revista de la Cepal, No. 38, Agosto de 1989, Pp.XXX.

servicing costs precisely when export earnings were declining. Unable to secure enough external credit to make up for the shortfall in export and fiscal revenues, countries throughout the region were forced to undertake strong expenditure-containment measures. The simultaneous contraction of economic activity in these countries had a negative multiplier effect on the regional economy. At the same time, armed conflict in El Salvador and Nicaragua and political unrest elsewhere began to tear the region apart, leaving behind a sequel of death, destruction, confusion and disarray from which the area is only now beginning to recover.

Partly because of the political upheaval enveloping the region, there was no concerted response to the crisis by regional governments. Each country confronted its problems as best it could.[2] In retrospect it is clear that these divergent responses deepened the crisis and contributed to the progressive disintegration of the region.

C. Trade and Payments Policies in the 1980s

Due to the severity of the payments crisis during the early 1980s, the overall thrust of the trade and payments policies throughout the area was to constrain import growth. Since about mid-decade, though, the emphasis in most countries has shifted towards the promotion of non-traditional exports towards markets outside the CACM.

1. Payments Regime

Central America had traditionally been a low inflation area, long accustomed to fixed nominal exchange rates. Thus, when the payments crisis struck in the early 1980s, instead of adjusting the exchange rate, these countries resorted to all sorts of exchange controls to try to deal with the external imbalance. The reticence to devalue and the imposition of exchange controls proved very counterproductive, because it contributed to currency speculation and capital flight, created enormous distortions and opportunities for corruption, increased transaction costs and required a more severe fiscal and monetary contraction to cope with the balance of payments problem.

Payments policies varied considerably from country to country. Costa Rica was the first (1983) to consolidate its foreign exchange market, devalue the currency and establish a crawling peg tied to the US dollar and periodically adjusted by inflation differentials. Guatemala and El Salvador maintained multiple exchange rates and other controls until 1989, when they consolidated their foreign exchange markets and established a managed float; Honduras did so in 1990. Nicaragua is a case apart. The political and economic dislocation led to hyper-inflation and a total debasing of the

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2/ For a detailed account of the process of economic reform in that period see Saborio, Sylvia "Central America" in Williamson, John (Ed.) Latin American Adjustment: How Much has Happened?, Institute for International Economics, Washington, D.C., April 1990.

currency. A currency reform and stabilization program have only recently been put in place. A summary of the main macroeconomic indicators for these countries during the 1980s is presented in Table 1.

Such disparate responses to the crisis produced wild gyrations in real exchange rates which, coupled with the web of restrictions that were put in place to ration foreign exchange, dealt a severe blow to intra-regional trade flows. Since scarce foreign exchange was allocated so as to favor "essential" imports --which most regional products decidedly were not-- such imports ended up bearing the brunt of the restrictions. The situation got even worse with the progressive weakening and eventual collapse (in 1986) of the regional payments clearing mechanism (Camara de Compensacion Centroamericana). This mechanism was used to settle outstanding bilateral balances among regional partners on a semi-annual basis. The system began to fail when Nicaragua started to accumulate sizable deficits which it was unable pay back. Eventually, regional exchanges were limited to cash or barter terms only. As a result, the share of intra-regional in total trade plummetted from over 25% in 1980 to only 11% in 1986.

2. Import Regime

The common external tariff (Arancel Uniforme Centroamericano) and the regional system of fiscal incentives (Convenio Centroamericano de Incentivos Fiscales) had been the lynchpin of both import and industrial policy in the region since the creation of the CACM. In the early 1980s, however, measures other than tariffs became the main policy tools to effect shifts in the size and composition of imports.

In addition to the vast array of exchange controls noted above, there was widespread use of import surcharges and prior import deposits, not only to curb imports but also to generate fiscal revenues (in the case of surcharges) and to reduce liquidity (in the case of prior deposits). Even though their effect is analogous to that of tariffs, authorities preferred to used these "disguised" tariffs because they could do so without technically violating the common tariff schedule, and also, because in some cases, it was the only form of taxation that did not require a lengthy and controversial process of Congressional ratification. Quantitative restrictions, particularly import licensing, were also resorted to, primarily to allocate scarce foreign exchange but also in order to maintain domestic support prices for a handful of basic agricultural products.[3]

In 1984, as part of its adjustment program, Costa Rica initiated a campaign to revamp the region's tariff regime which culminated in the first comprehensive reform of the common external tariff since 1969. The reform, which took effect 1/1/86, repealed the regional system of fiscal incentives;

3/ Quantitative restrictions have never been popular in Central America. This has probably less to do with sound commercial policy than with the fact that in a region of chronic fiscal deficits, quantitative restrictions are considered an inferior form of protection, insofar as they generate private rents rather than fiscal revenues.

eliminated all specific import duties and other levies, replacing them with ad valorem rates in the common tariff schedule; and reduced the level and the dispersion of nominal tariff rates.

The average nominal tariff was lowered by about 50% relative to the ad valorem tariff equivalent existing prior to the reform. (See Table 2). The impact on effective rates of protection is more difficult to ascertain, however, given the large number of exemptions, exceptions and surcharges to which imports were subjected prior to the reform. Several studies reveal that, in fact, neither the structure nor the level of effective protection changed very much in most cases.[4] Apparently the reform merely eliminated the "water" from the tariff schedule.

Since then, unable to agree on a common course of action, countries have followed separate paths to trade reform under structural adjustment programs and their process of accession to the GATT, invoking escape clause provisions of the regional accord. Costa Rica and Honduras initiated wide-ranging trade and other reforms, supported by World Bank structural adjustment lending, in 1989. More recently (1991), El Salvador and Nicaragua also undertook similar actions. As of June 1991, tariffs plus other duties on extra-regional imports ranged from a narrow band of 5%-35% in El Salvador to a wide band of 5%-95% in Nicaragua.

With the lowering of political tensions, however, a marked shift towards the economic re-integration of the region has occured. This is best symbolized by the series of commitments to buttress the regional framework undertaken by the presidents of the Central American countries at their summit meeting in San Salvador in July, 1991. Among other measures, they agreed to revert to a common external tariff schedule by end-1992. With few exceptions[5], the schedule will be confined to a range of 5%-20% and will consist of four basic rates: 5% on non-competing capital and intermediate goods, 10% on competing capital and intermediate goods, and rates of 15% and 20% on non-competing and competing consumer goods, respectively. The presidents also called for the removal of obstacles to intra-regional trade in manufactures and vowed to liberalize trade in agriculture within agreed-upon price bands by mid-1992. It was noteworthy that Honduras, which had formally withdrawn from the CACM in 1969, agreed to rejoin the union and abide by the proposed timetable, and that Panama, which has never been part of the CACM, has began to explore the possibility of eventual participation in the regional scheme.

4/ See World Bank, "Trade Liberalization and Economic Integration in Central America." Report No. 7625-CAM, Feb., 1990.

5/ The main exceptions are a time-limited exception from the 20% maximum tariff for textiles and footwear in Costa Rica, to be phased out by 1994, and the exclusion of a small number of "essential" and "fiscal" products from the 5%-20% bounds. See, La Declaracion de San Salvador, the joint presidential statement issued at the San Salvador Summit, El Salvador, July 17, 1991.

3. The Export Regime

The ultimate purpose of the import liberalization measures noted above was to reduce the anti-export bias of these economies and thereby encourage the development of export oriented activities. In addition, a variety of export promotion schemes and incentives were put in place, particularly to stimulate non-traditional exports to markets outside the CACM. A summary description of the three basic schemes currently in existence is presented in Table 3.

The experience with such schemes has been mixed. Costa Rica has been by far the most successful in diversifying its export structure: over the last 7 years, non-traditional exports have been growing at an average annual rate of around 27%, and this must be due, at least in part, to the change in incentives (including the management of the exchange rate). The fiscal cost of the program, however, has been very high and continues to spiral. Tax rebates alone currently account for nearly 7% of the government budget. Moreover, since such rebates are given on the gross value of exports, only a fraction of the money actually contributes to exports, the rest subsidizes imports instead! Indeed, a recent study by the IMF found that the direct cost of the subsidy, not counting the administrative costs, averaged out to $2.27 per $1 of additional net exports.[6]

Thus, even if these countries continue to pursue an outward-oriented strategy, as they have vowed to do, a mayor task before them will be to redesign the instruments of their export drive, putting less emphasis on fiscal incentives that benefit individual exporters and more on measures that contribute in a more direct and lasting way to improve the external (and internal) competitiveness of the economy as a whole, such as improvements in infrastructure and transportation, export finance, customs administration, etc.

A separate but related task will be to map out a strategy to respond to the challenges and opportunities presented by the international environment, particularly those related to the Enterprise for the Americas Initiative and other regional preferential agreements.

III. THE INTERNATIONAL ECONOMY: CHALLENGES AND OPPORTUNITIES

Before considering the options and implications of embracing a more outward-oriented policy stance, it would be useful to highlight the main features of Central America's trade relations and review how they might be affected by major unfolding developments in the international sphere, notably the Uruguay Round, EC-92, and the establishment of a North American Free Trade Area (NAFTA), comprising Canada, Mexico and the US.

6/ Hoffmaister, Alexander, "The Cost of Export Subsidies: Evidence from Costa Rica", IMF Working Paper, WP/91/94, October 1991, p.19.

A. Present Trade Profile

The U.S. is both the dominant market and supplier to CA, accounting in each case for around 43% of the total. Apart from absorbing a large share of the region's traditional exports (some 60% in the case of bananas, 40% for coffee), the U.S. is also the fastest growing market for a number of the region's non-traditional exports, particularly clothing and textiles; currently, the US absorbs over 55% of total CA textile and apparel exports. For its part, the relative importance of the European Community as a trading partner has remained essentially unchanged over the last decade: the EC absorbs around 20% of CA exports (mostly coffee and bananas) and supplies about 10% of CA imports (mostly chemicals and transport equipment). Trade with Japan and other industrial countries is relatively unimportant, accounting for less than 10% of the total, although Japan is an important supplier of automobiles to the region (44% of the total). (Tables 4 & 5).

Trade with other Latin American countries is generally low, except for oil imports supplied mainly by Venezuela and Mexico. On the whole, Latin America purchases around 6% of CA exports and supplies some 19% of its imports (including fuel, which accounts for nearly half of those shipments). Canada, meanwhile, supplies only around 1% of the region's imports and buys about 3.5% of its exports.

The most dramatic shift in trade patterns has occurred within the region itself. After having risen sharply since the inception of the CACM, intra-regional trade fell precipitously in both absolute and relative terms in the 1980s. Between 1980 and 1986, the share of intra-regional exports dropped from over 25% to only 10% of the total: this constitutes a fall of 63% in the dollar value of such exports. Since then, intra-regional exports have expanded, but in 1990 they were still 41% below their 1980 level. Intra-regional imports have, likewise, declined in absolute and relative terms: in 1990 their dollar value was 35% below their value in 1980. It is interesting to note that with the near demise of the CACM in the 1980s, CA's trade flows reverted to a pattern remarkably similar to that prevailing 25-30 years ago.

As far as the commodity composition of trade is concerned, while some export diversification has occurred in individual countries (notably Costa Rica and Guatemala), the region as a whole continues to depend on a small number of primary commodity exports to developed country markets for a large share of its foreign exchange earnings. Indeed, throughout the 1980s the structure of exports became increasingly concentrated on traditional products: the share of coffee and bananas in total exports rose by over 10 percentage points (to nearly 55% of the total), while exports of manufactures declined in both absolute and relative terms during the decade, as the collapse of intra-regional trade was only partly offset by increases in sales to third countries. For the region as a whole, the share of manufactures in total exports dropped from 26% to only 20% during this period.

The structure of imports, meanwhile, has remained quite stable over time: capital goods and intermediate manufactures make up some 2/3 of the total, manufactured consumer goods account for an additional 14-16%, food imports amount to an extra 11-12% of the total, and the balance is made up of fuel imports, whose share fluctuates with movements in the price of oil.

B. Market Access Conditions and Prospects

Given Central America's trade patterns, access conditions to the U.S. and EC markets are critical to future export prospects. Access to those markets will be affected in important --if as yet uncertain-- ways, by three major developments: the Uruguay Round, EC-92 and the North American Free Trade Area (NAFTA). Following a review of present access conditions to those markets, the potential impact of such developments on future market access will be considered.

1. The Present Situation

On the whole, tariffs in industrial markets are not important restraints to Central American exports. In the U.S., for instance, the average trade-weighted tariff rate (using 1986 trade weights) on Central American exports was only 1.8% in 1989. Moreover, nearly 80% of all CA exports enter the U.S. duty-free. In addition to duty free access under MFN and GSP, these countries enjoy duty-free access on a further group of commodities under the Caribbean Basin Economic Recovery Act of 1983, commonly referred to as the Caribbean Basin Initiative (CBI).[7] Certain sensitive items of export interest to the region, however, are explicitly excluded from duty treatment under the CBI (i.e. textile and apparel, footwear, leather goods, canned tuna), while others enjoy duty free entry subject to certain restrictions (i.e. sugar, ethanol and beef). On the other hand, preferential access and duty treatment is given to exports made under production sharing schemes using U.S. components (under HTS subheadings 9802.00.60 and 9802.80). Special provisions apply in case of articles made entirely of US made materials, the net effect of which is to extend duty free entry and guaranteed access to products otherwise not eligible for preferential treatment, such as apparel, footwear, leather goods, etc. (See Table 6.)

Tariffs on CA imports are generally low in the EC as well. About 30% of CA exports enter the EC duty free, an additional 7% are eligible for treatment under the GSP, and another 46% enter at a duty of 5%.[8] Excise duties are, however, an important barrier in some individual markets, e.g., there is a 40% excise tax on coffee in Germany.

Non-tariff barriers constitute the most important impediment to industrial country markets for CA products. NTBs of various kinds (including

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7/ Nicaragua has been excluded from this program. The original program was established in 1983 for a period of twelve years. It was liberalized slightly and made permanent in 1990.

8/ See Marc Pierini, "EC Eyes New Ties in Central America", Europe, November/December, 1984, pp.30-31.

health and safety regulations which may or may not have protective intent) affect about 15% of total CA exports to the US. However, the incidence of NTBs is very high on certain categories of goods. For example, almost 70% of CA exports of food products (other than coffee and bananas) and over a third of CA exports of textile and apparel to the US market are subject to NTBs. (See Table 7). As noted, though, the U.S. provides additional access to CBI beneficiaries through the establishment of guaranteed access levels (GALs) for textiles and clothing products assembled from fabric produced and cut in the U.S. In the case of Costa Rica and Guatemala, these arrangements have permitted considerable expansion in these countries' apparel exports to the U.S.

The overall incidence of EC-wide NTBs is quite small, affecting only 2% of CA exports. However, NTBs are an important deterrent in the case of food products, 25% of which face hard core NTBs[9], and in the case of textiles and apparel exports, where over 20% do so. Furthermore, these figures understate the actual incidence of NTBs in Europe, since they do not reflect restrictions imposed at the national level (such as quotas on bananas, or the German excise duty on coffee).

The incidence of trade restrictions on individual CA countries varies due to differences in the commodity composition and geographic distribution of their trade (See Table 8). Costa Rica faces higher tariffs and NTBs in the U.S. market, because a larger share of its exports to that market consists of non-traditional agricultural and industrial products that face above average restraints. On the other hand, Honduras is the hardest hit by NTBs in Europe, on account of its high reliance on bananas and other food products to those markets.

2. The Impact of the Uruguay Round

Given the uncertainty surrounding the outcome of the Uruguay Round, only qualitative judgements about the potential impact on Central America's trade interests of various issues under negotiation can be ventured at this point.[10]

9/ Hard Core NTBs involve quotas or other quantitative restraints including voluntary export restraints, reference prices, tariff quotas, and variable levies. Total NTBs include, in addition, countervailing and antidumping duties or investigations, safety and health regulations and other "technical" restraints.

10/ For example, in the area of tariffs, CA countries would benefit from the extension to them through the MFN principle of lower tariffs that may result from the Round. But these gains would be offset in part by the erosion of preferences enjoyed under the GSP and the CBI. While these effects can not be assessed quantitatively without knowing the outcome of the negotiations in tariffs, it is likely that the effect would be small, since tariffs facing their exports are on the whole quite low.

In <u>tropical products</u> and especially coffee and bananas, the main potential benefit from the Round could result from reduction in excise taxes on coffee in Germany to the much lower EC average, and loosening of restrictions on banana imports from non-ACP countries. It is unclear at this point whether the EC would be prepared to introduce these measures as part of the Round or, as it appears more likely, modify its policies as part of EC-1992 (see below).

Regarding other <u>agriculture</u>, the effects on CA could be quite mixed. On the one hand, these countries are net importers of temperate foodstuffs and would be adversely affected by an agreement that reduced developed country subsidies in this area. On the other hand, they stand to benefit handsomely from any arrangement that reduced the level of protection for sugar in the U.S. and EC markets. Changes in health standards could also yield mixed results. To the extent that the use of standards with protective intent (i.e., beef) is curbed, CA countries stand to gain; but the adoption of stricter health standards in other cases (i.e., shrimp) may hurt CA non-traditional exports.

The liberalization of <u>textile trade</u> could yield significant benefits for CA exporters in the long term. In the short term, however, liberalization of the MFA may result in losses to competitors from East Asia in the U.S. market, both directly and through the dilution of some of the benefits they now enjoy through the CBI. In fact, CA textile and apparel exporters have broken ranks with the International Textile and Clothing Bureau (ITCB) and argued for a longer phase-out period for the MFA and interim measures to protect their market share from larger and more established competitors in Asia.[11]

Finally, to the extent that these countries are embracing an outward-oriented strategy, they have a stake in the wellbeing of the international trading system. They, therefore, stand to gain from improvements in the <u>rules</u> of the system, especially regarding the mechanisms for the settlement of disputes and the use of trade remedies, such as anti-dumping, countervailing and safeguards, particularly by the US and EC. By generating uncertainty about future access to those markets, such actions inhibit investment in the export sector and undermine political support for trade liberalization.

3. <u>EC-1992</u>

The proposed establishment of a single market in Europe by 1992 aims at increasing the competitiveness of European suppliers by eliminating remaining impediments to intra-European commodity and factor movements, and by adopting unified rules for the treatment of certain imports from outside the EC, previously under national jurisdiction. These proposals are expected to result in increases in efficiency and income, which would have potentially positive effects on third countries, including those in Central America.

<u>11</u>/ Scott Norvell, "Central American Textile Firms Back Slower GATT Transition", <u>Journal of Commerce</u>, Nov. 13, 1991.

Against this, there would be some trade diversion, resulting from shifts away from third country suppliers to the EC due to its enhanced competitiveness. Given the relatively weak trade links between CA and the EC, the income effect of EC-92 on CA is projected to be small. According to one estimate, for every 1% of extra GNP growth in the EC, GNP in Latin America as a whole could be expected to rise by 0.2%.[12]

Most trade creation will occur in the case of primary commodities not produced in the EC or by ACP beneficiaries, while most trade diversion can be expected in manufactures. As noted above, the main benefit for Central America could result from actions to reduce the high excise duties on coffee in Germany and from possible erosion of ACP preferences in bananas. On the other hand, tightening of EC health standards could affect adversely CA non-traditional agricultural or fishery exports. Of greater concern are the multitude of preferential arrangements currently in place in the EC, including those to the ACP countries, the recently extended preferences to the Andean Group[13], and those likely to be established with countries in Eastern Europe. In addition, there is the danger that the EC would decide to use Community-wide quotas or other protective devices such as anti-dumping, in lieu of the previous national quotas, to prevent expansion of CA exports in sensitive sectors.

In sum, while EC growth can be expected to provide some stimulus to CA exports, there is little that the CA countries can reasonably expect in the form of improved opportunities for export expansion in the EC market -- other than for coffee and bananas and a few other traditional exports.

4. North America Free Trade Area

The establishment of a North American Free Trade Area encompassing the US, Mexico and Canada, poses some thorny questions for Central America. As the first step in the process of consolidating a hemispheric-wide free trade area, it conjures up dizzying visions of the potential of a mega-market of 730 million people with a combined GDP of $6.7 trillion. On the other hand, the NAFTA poses some serious immediate threats and future challenges to Central America. In the first place, given that Mexico is a competitor on practically all items exported by CA to the US, the inclusion of Mexico in NAFTA would result in the erosion of some of the preferences these countries

12/ Sheila Page, "Some Implications of Europe 1992 for Developing Countries", ODI, December, 1990.

13/ In late 1990, the EC granted a four year reprieve on customs duties for imports from Colombia, Peru, Bolivia and Ecuador as a reward for their anti-drug policies. As a result, these countries now enjoy a margin of preference of up to 22% in EC markets over their CA competitors on a number of products, including coffee, seafood, cut flowers, plants and some foodstuffs. Costa Rica, Ministerio de Comercio Exterior, San Jose, (mimeo). UPDATE: As of 1/1/92, the EC agreed to extend essentially the same privileges to Central America.

currently enjoy in terms of access to the U.S. market under the CBI. In addition, Mexico may obtain preferential access to the North America market for products such as textiles and apparel, which are excluded from the CBI. This would leave CA (and others) with negative preferences on those items in the US market.

Recent estimates indicate that, next to Brazil, CA would experience the largest amount of trade diversion from the preferential elimination of tariffs on Mexican goods entering the U.S. market -- nearly 20% of the total trade displacement for the whole of Latin America.[14] While this effect is currently small relative to the amount of trade involved, the potential for trade displacement would grow over time, as new investment decisions (and hence future trade flows) would reflect the shift in preferential access to the US market in favor of Mexican exports implied by NAFTA.

Indeed, investment diversion is potentially a more serious problem for Central America than trade diversion per se. Even with preferential access to the US market and generous incentives for investment in export-oriented activities, these countries have had a hard enough time attracting foreign direct investment from the US and elsewhere[15] . With Mexico now becoming a springboard for unrestricted entry into the US and Canadian markets, whatever locational advantage Central America had as an investment site to serve the North American market will disappear. To be placed at such competitive disadvantage at a time of global capital scarcity, is a matter of great concern to the region. Such concern is well justified. Already, before the NAFTA is even concluded, anecdotal evidence is beginning to accummulate of firms relocating to Mexico or changing their investment plans so as to be advantageously positioned by the time the deal is struck[16]. Such imminent, though unintended, fallout from NAFTA creates a strong incentive --and a strong case-- for the countries of Central America to seek to obtain assurances from the U.S. that their access to its market would be at least as favorable as that to be provided to Mexico.

In conclusion, the Uruguay Round and policy modifications related to EC 1992 are likely to offer some modest opportunities to CA countries for enhanced market access, especially regarding primary commodities, whereas the

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14/ Refik Erzan and Alexander Yeats, "Free Trade Agreements with the United States: What's in it for Latin America?" in Sylvia Saborio, ed., U.S. - Latin America Trade Relations in the 1990s, ODC (forthcoming). The calculation assumes that whatever NTBs may exist would be relaxed so as to let the full effect of the tariff reduction play out.

15/ USITC Annual Report on the Impact of Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers. Sixth Report, 1990, Washington, D.C., Sept., 1991.

16/ FEDEPRICAP, "A Central American Private Sector Perspective on Some of the Main Issues as Regards NAFTA and the Formation of an FTA between CA and the US", Nov. 21, 1991.

NAFTA is likely to entail trade and investment diversion from the area. On the whole, though, what emerges from the analysis is that at present, access barriers to the region's exports are not very high, except for certain categories of products which currently represent a relatively small (though growing) share of the total. As the "export bundle" of these countries shifts, however, they will encounter increasing obstacles to their exports. Moreover, their export interests will be adversely affected by the erosion of preferences, particularly in the case of NAFTA, but also on account of preferences extended by the EC to the Andean Group, and the recent extension of CBI benefits to those same countries by the US.[17]

IV. MEETING THE CHALLENGE: CATCHING THE FREE TRADE EXPRESS

Given the evolving external environment, how should the Central American countries react to the challenges and opportunities before them? What role should the CACM play in the future development strategy of these countries? Should other regional arrangements (beyond the CACM) be pursued? Finally, what are the basic domestic policy requirements for the success of the chosen strategy?

A. Strategic Choices Regarding the External Environment

Small countries such as those of Central America, have no choice in terms of long term growth, except to adopt an outward looking trade strategy. Options do exist, however, as to the way in which such a strategy can be pursued in different international settings, particularly with a view to mitigating the transition costs and the degree of external vulnerability associated with a more open trade policy.

Fundamentally, the choice boils down to whether trade ought to be liberalized multilaterally, or in the context of some preferential arrangement. Economic analysis indicates that from the standpoint of world welfare, non-preferential multilateral liberalization, is almost always a first best alternative compared to the formation of preferential Free Trade Areas (FTAs). This does not imply, however, that members of a preferential FTA do not stand to gain from it, or even that both policies need to be mutually exclusive. In fact, we will argue that the countries of Central America should pursue such a "hybrid" strategy with the ultimate goal of becoming better integrated into the world economy at large.

What we propose is a three-pronged approach. As GATT members, these countries should continue to participate in the Uruguay Round, reaping as many benefits as can be had, assuming as much of the responsibilities as possible, and using the GATT as a vehicle to move foreward the domestic reform

17/ The "Andean Trade Preferences Act" thats extends CBI privileges to Colombia, Bolivia, Ecuador and Peru in recognition of their anti-drug efforts, was signed into law on December 4, 1991.

agenda. At the same time, they should take steps to revamp and breathe new life into the CACM. Finally, they should pursue preferential trade arrangements with the US and possibly others as well, in the context of the Enterprise for the Americas Initiative.

B. The Role of the CACM

The traditional notion of the CACM as an alternative to greater integration in the world market is essentially dead. In our view, the CACM could still usefully play a dual role: as a vehicle to expand the regional export base, thereby facilitating the internationalization of these economies, and as a framework for policy co-ordination vis-a-vis the rest of the world.

In order to play this dual role, the CACM itself needs to be revitalized. To this end, all remaining cross-border barriers and exchange restrictions affecting trade in regionally produced manufactures need to be removed. The liberalization of intra-regional trade in agriculture, following the adoption of a common price-based mechanism for the treatment of extra-regional imports, has already been agreed to and should be in place by mid-1992. Beyond the removal of barriers, per se, the restoration of the clearing arrangement for regional payments will be crucial for the reactivation of intra-regional trade. In order to avoid recreating the circumstances that led to the collapse of the previous arrangement, however, individual countries will need to pursue macroeconomic and exchange rate policies that prevent serious disequilibria from developing and exerting pressure on either intra-regional or extra-regional payments. The shift towards more market-oriented policies by each of these countries over the last few years should help ensure such convergence by relying more on market forces than on negotiated solutions to attain that objective.

As far as Central America's relations with the rest of the world are concerned, the commitment to revert as of 1992 to a common external tariff schedule --which is also simpler, more transparent, and confers much lower levels of effective protection to regional industry-- is a very important development, for it signals that the process of regional consolidation will not be, in fact, an inward-oriented one. This raises the question of the role of regional cooperation within an outward-oriented strategy.

There are a number of areas in which regional cooperation could enhance the external competitiveness of these countries by pooling resources, reducing unit costs and avoiding duplication. For instance, they could establish joint commercial offices, issue joint visas, establish joint inspection and quality control centers, set up joint market information networks and distribution channels, undertake joint manpower training, etc. They could also go a step further and merge the various national airlines into a regional carrier, integrate capital markets on a regional scale to reduce the cost of financial intermediation, and seek to expand the region's technological base through joint R & D, so as to eventually transcend the limitations of the maquila. In addition, they should seek to harmonize their policies --in areas such as taxation, investment, export promotion, intellectual property rights-- so as to avoid creating unnecesary (and often unintended) distortions in the allocation of resources region-wide.

Finally, the CACM should provide the framework for policy coordination vis-a-vis the rest of the world. Essencially, what is required is that these countries agree on the basic parameters for trade reform beyond 1994 and adopt a united stance with respect to the myriad proposals for preferential regional trade arrangements that have sprang up ever since the Enterprise for the Americas Initiative was launched by President Bush in mid-1990.

C. Other Regional Arrangements

From the standpoint of individual countries, the calculus of the costs and benefits associated with an FTA will depend very much on the particular trade relations that exist between a given country and its potential trade partners. Specifically, the benefits from an FTA would be higher: (a) the greater the importance of the partner as a market for the country's exports; (b) the higher the level of protection in the partner's market for the country's exports prior to the FTA; and (c) the greater the proportion of imports supplied by the potential partner before the creation of the FTA.

On the basis of these criteria, there would be an incentive for CA countries to seek a free trade arrangement with the U.S. (or NAFTA). The US is the largest and most dynamic market for the region's exports. The US (together with Canada and Mexico) already absorbs nearly half of CA total exports, and an even larger share of its non-traditional agricultural and industrial exports. At the same time, the U.S. is an important supplier of imports to these countries even without the benefit of preferences in their markets. This suggests that the cost in terms of trade diversion of granting preferences to the U.S. would be small, with the possible exception of automobiles, where the potential for displacement of Japanese imports seems significant.

In terms of expanded access to the US market, though, the static gains from an FTA would be rather slim, given that existing barriers to that market are generally low and that 80% of the region's exports already enter the US duty free. Recent estimates suggest that the preferential elimination of all US tariffs on CA's exports would boost such exports by less than 8% (16.5% in the case of Costa Rica, which currently faces the highest access barriers).[18] Still, it is a fact that the sectors most heavily protected in the US market are precisely those activities in which CA countries are trying to diversify. The preferential elimination of such barriers (both tariffs and NTBs) would, therefore, enhance the potential for future exports of those commodities.

18/ See Erzan and Yeats (1991). This assumes that existing NTBs are relaxed concommitantly so as to allow the full effect of the tariff to play out.

Another advantage of an FTA is its contractual nature, i.e. it would lock-in conditions for access to the US market that could not be unilaterally modified by the US without appropriate procedures and compensation, as is the case with unilateral preferences granted under the CBI and GSP. This is important, because CA's ability to take advantage of such market opening will critically depend on the expansion of its export capacity, and without assurances of continued access to the US market, it would be difficult to attract the investment necessary to bring this about. This argument cuts both ways, however. Since an FTA is a reciprocal arrangement, it would also impose additional obligations on Central America, not only in terms of liberalizing its own trade regime, but in such areas as investment, services, intellectual property protection, state trading, subsidies, etc.[19] While reforms in many of these areas are underway and are consistent with the avowed objective of seeking fuller integration of CA in the international economy, the economic (and political) costs of such domestic adjustments should not be taken lightly.

In the end, the most compelling reason for CA to seek a free trade agreement with the US is a defensive one. While these countries might have prefered to remain essentially free riders, enjoying unilateral though limited preferences in the US market, the entry of Mexico (and possibly others) into NAFTA leaves them no option but to seek to join the FTA as well. Otherwise, their competitive position vis-a-vis Mexico in the US market would be undermined and they would also face a competitive disadvantage vis-a-vis the US in the Mexican market. The cost of exclusion from the FTA would thus be high, and it would rise with each new entrant to the preferential arrangement. Central American countries, therefore, have an incentive not only to join the FTA, but to do so as soon as possible, not merely to avoid the cost of trade diversion, but to reap some of the investment benefits of being among the first to join the FTA.

Reaching a full-fledged FTA between the US and the countries of Central America in the near future is a practical impossibility, given that the US refuses to contemplate further agreements until the NAFTA is concluded and assessed, that there are a number of other candidates, and that Central America is not ready to fully liberalize trade at this time. For this reason, we propose an interim arrangement, whereby the countries of CA would be temporarily protected from the unintended fallout of Mexico's entry into NAFTA, while they carry on their economic reforms and become ready to assume reciprocal obligations under an FTA. (See below.)

Aside from the US initiative, a number of proposals for preferential trade arrangements have been put forth by other countries in the region, notably Mexico, Venezuela, Colombia, and CARICOM. Is it in the interest of Central America to enter into preferential trade arrangements with these countries? According to the criteria laid out above, on purely economic grounds there would be little to be gained by CA entering into separate

19/ See Carla A. Hills, Toward a Dynamic New Era of Growth, statement at the Central American Conference on Trade and Investment, San Jose, Costa Rica, August 12, 1991.

agreements with these countries. First, because trade links between CA and each of these countries have traditionally been very weak (except for oil imports from Venezuela and Mexico). And second, because while most of them had highly protected markets in the past, over the last few years they have unilaterally reduced very substantially their level of protection so that the potential margin of preference in those markets is by now relatively small. Thus, even though the Mexican and Venezuelan proposals embody the concept of "relative reciprocity", whereby Central American exports would enjoy freer access to their markets than they would expect in return for a number of years, these proposals on their own are unlikely to amount to much.

When looked at from a broader perspective, however, the set of proposals make more sense, for they suggest the formation of a "Grand Caribbean Basin" region. If and when trade were liberalized in a preferential but consistent manner among these countries, the region could become a building block for the larger vision of a hemispheric free trade area. As a means to that larger goal, such a development would have the virtue of exposing countries to rising levels of external competition, of maintaining the momentum for trade liberalization, and of eventually facilitating an agreement between the US and a large group of small countries that even in the aggregate would be of only marginal economic interest to the US.

D. Domestic Policy Implications of Trade Liberalization

In terms of its implications for domestic policy, it matters little whether the economies of Central America liberalize their trade multilaterally or in the context of an FTA with the US: either way they would be exposed to the rigors of international competition and would need to exercise great discipline in the management of macroeconomic policy.

Significant changes in the competitive environment will require in many cases a fundamental reorientation in the attitude of firms previously operating in a sheltered market. Profitability would tend to depend more on efficiency and less on securing rents through administrative intervention or protection, whether they produce for the domestic market or for export. This is likely to entail significant adjustment costs. Considering the upheavals these economies went through during the 1980s, it is possible that the most vulnerable firms will have already disappeared and those that remain should be able to handle higher levels of competition within a generally more propitious economic environment. Nevertheless, competitive pressures will increase as trade barriers are progressively eliminated, so that additional displacement of inefficient firms appears inevitable.

A parallel expansion in exports will be needed to absorb labor displaced from the import competing sector. Indeed, in the face of severe limitations in these countries' capacity to assume additional debt, export growth will become an increasingly important determinant of their ability to adjust and grow. Their participation in an FTA, however, would likely limit their use of particular export promotion instruments such as export subsidies which had been extensively used in the past. Government support for exports would still be needed, but it should be geared to improving export support activities, such as infrastructure, cutting red tape, and, most important, providing a healthy macroeconomic environment, all of which are essential for a vigorous export supply response.

Experience has shown that the success of trade reform hinges on macroeconomic stability.[20] Achieving such stability will be a daunting challenge for these countries. Fiscal deficits in several of them are already at unsustainable levels and need to be reduced. Trade liberalization, however, is likely to have an adverse impact on their budgets, both by reducing revenues and increasing expenditures. Currently, import duties alone represent 20 to 40% of total tax revenues in these countries. Deep tariff cuts are likely to lead to a net decline in fiscal revenues, even if account is taken of a parallel reduction in export subsidies, exemptions, and in contraband imports. Moreover, a commitment to a liberalized trade regime implies the need to rely on exchange rate adjustment rather than on direct trade and foreign exchange controls to maintain external balance. In order to avoid a deterioration of the external accounts as a result of the import liberalization, it may well be necessary to undertake a compensating nominal devaluation. The latter, however, would exacerbate the fiscal problem as it would increase the local currency cost of servicing the large external debt obligations of these countries.

Thus, trade reform in Central America cannot succeed in the absence of comprehensive tax and fiscal reform. Governments will need to revamp their tax system to secure additional fiscal revenues. Tax reforms in other developing countries have typically focused on the introduction of VAT as well as more effective collection of other existing taxes. If a VAT or a similar system were to be introduced however, it would need to be harmonized across countries; otherwise, it would lead to distortions in resource allocation within the region by creating artificial incentives for locating investment in the countries with the lowest tax rates.

In sum, significant trade liberalization would require major changes in the domestic economy, both at the micro and macroeconomic level. For firms, changes are needed in incentives and attitudes. At the macro level, changes are needed in policies and institutions, especially in the fiscal system. Such changes will take some time to implement. But unless they are undertaken, full trade liberalization will not be sustainable.

V. CONCLUSIONS AND RECOMMENDATIONS

1. Over the last few years, the countries of Central America have taken steps to stabilize their economies and to introduce domestic and trade reforms aimed at improving resource allocation and increasing competition in their domestic markets. While a lot remains to be done, their governments remain committed to moving forward towards integrating their

20/ V. Thomas, Kazi Matin and J. Nash, "Lessons in Trade Policy Reform", Policy & Research Series No.10, World Bank, March 1990.

economies more fully into the world market. We have suggested that in doing so they should follow a three-pronged approach:

* continue to participate fully in the multilateral round of trade negotiations, because as small open economies, they have a great stake in the health of the international trading system.

* revitalize the CACM, not as a sheltered regional market for inefficient domestic firms, but as an expanded base to enhance the external competitiveness of the regional economies, and as a framework for coordinating policy vis-a-vis the rest of the world. It is imperative that these small economies take a united stand on matters of mutual interest to enhance their economic weight and negotiating position.

* seek preferential trade arrangements with the US, and possibly others, in the context of the EAI, if it serves the larger purpose of liberalizing trade on a broad basis, but be leery of partial, isolated agreements that may divert more trade than they create.

2. Mexico's entry into NAFTA could seriously harm the economic interests of Central Central by diverting trade and investment from the region. Unlike others in the Caribbean Basin who enjoy preferences in the EC markets under the Lome Convention, and in the Canadian market through Caribcan, the attraction of Central America as an investment site rests almost exclusively on its preferential access to the US market. With Mexico as a springboard for unrestricted entry into the US and Canadian markets, whatever locational advantage Central America had as an investment site to serve the North American market will be significantly reduced.

These countries can ill afford to see their access to the U.S. market curtailed at the very time that they themselves are embarking on an important trade liberalization effort, nor can they afford to lose potential investment inflows as they set out to reconstruct their war-torn and crisis-battered economies and hone them to meet the challenges of international competition. After all, the premise behind the promise of trade liberalization as an engine of growth is that as inefficient industries succumb to competitive pressure, new export activities will replace them. For this to materialize, however, plenty new investment will be needed.

The problem is that while the threat of trade and investment diversion is imminent --indeed, the latter is already happening <u>in anticipation</u> of a successful NAFTA-- the US is not willing and the Central American countries are not ready to avert such a threat by entering into a full-fledged FTA any time soon.

In order to bridge that time gap, we recommend that an interim provision be adopted (either as part of NAFTA itself or as a separate bill), whereby any preferences granted by the US to others (beyond those provided by the CBI) between now and 1995, say, be extended to Central America as well. During this period, the countries of Central America would continue their economic reform process according to existing commitments under agreements with the World Bank, the IMF, GATT, USAID, etc., whose compliance could be monitored through the Framework Trade and Investment Agreements already in place between the US and each of these countries. By 1995, the countries of Central America would be in a position to assume additional obligations under a reciprocal arrangement with the US. By then also, if adjustment to the NAFTA has occured smoothly, the political climate in the US may be more amenable to completing the vision of a hemisphere-wide free trade area. While the proposed interim measure is independent of whether or not the NAFTA agreement contains an accession clause, such a clause would clearly facilitate the eventual transition to a full-fledged FTA.

Such an approach would temporarily protect the countries of Central America from the unintended fallout of Mexico's entry into NAFTA, while at the same time providing a mechanism for the eventual transition from unilateralism to some type of reciprocity in U.S. commercial relations with these countries. It would cost the US virtually nothing, since these countries account for only about 1% of total US imports, and 80% of that is already duty-free. Yet, it would give these countries both a strong incentive and a fighting chance to sustain the process of trade and economic reform which they have undertaken.

3. While Central America should do all it can to obtain larger, preferential and more secure access for its products --particularly in the main and most dynamic market for its non- traditional exports-- it must recognize that, at present, the main obstacles to export growth are to be found on the supply, not the demand, side. Red tape, perverse incentives, inefficient financial intermediation, deficient transportation, inadequate infrastructure, insufficient market information, defective quality control-- all contribute to hold back export growth, regardless of how many market opportunities there might be. All Central American countries have, to a smaller or larger extent, initiated significant reforms to address many of these problems. Their total elimination, however, is a gigantic task that will require vision, perseverance and political courage to complete.

Indeed, developing an export culture in these countries is bound to be a long, drawn-out process, that will require major adjustments on the way both governments and entrepreneurs go about their business. The former must be prepared to exercise much more discipline in their own affairs than in the past, and must devise means to steer and support the process of transformation that are efficient, equitable and fiscally sound. The latter, in turn, must learn to succeed through the pursuit of excellence rather than the securing of sheltered markets and fiscal rents. Tough lessons, indeed. Yet, such are the demands of the brave new world of international competition these countries are seeking to join.

Table 1

CENTRAL AMERICA: BASIC MACROECONOMIC INDICATORS

	1979-83	1984-88	1989-90
Gross Domestic Product (average annual rate of change)			
Costa Rica	-0.2	4.6	4.6
El Salvador	-4.8	1.7	1.8
Guatemala	0.6	1.4	4.0
Honduras	1.0	3.9	1.2
Nicaragua	-2.5	-3.1	-4.0
Public Sector Deficit (% of GDP) (average of annual figures)			
Costa Rica	12.4	5.4	5.9
El Salvador	7.7	4.2	5.3
Guatemala	4.3	4.0	4.4[a]
Honduras	9.4	7.9	8.1
Nicaragua	18.0	42.3	31.4[a]
Current Account Balance of Payments (% of GDP) (average of annual figures)			
Costa Rica	-12.7	-4.3	-7.5
El Salvador	-1.7	1.2	-2.6
Guatemala	-3.8	-4.5	-6.2
Honduras	-9.6	-5.3	-7.3
Nicaragua	-15.5	-19.1	...
Consumer Prices (average annual rate of change)			
Costa Rica	37.4	15.3	17.5
El Salvador	13.8	22.1	20.1
Guatemala	9.0	16.6	25.7
Honduras	11.4	3.9	16.2
Nicaragua	32.7	3,232.9	6,850.0
Real Effective Exchange Rate (average of annual figures, index 1979=100)			
Costa Rica	85.9	81.8	86.0
El Salvador	120.7	151.3	155.0
Guatemala	106.1	82.8	62.7[a]
Honduras	112.2	121.2	72.6
Nicaragua	135.5	356.4	236.2[a]
Terms of Trade (average of annual figures, index 1979=100)			
Costa Rica	93.3	113.6	102.5
El Salvador	80.6	82.3	71.6[a]
Guatemala	93.0	93.6	80.2[a]
Honduras	95.0	96.0	89.3
Nicaragua	97.5	100.0	101.1[a]

[a] 1989.

Source: International Monetary Fund

Table 2

CENTRAL AMERICA: EXTERNAL LEGAL TARIFF

(percentages)

	Pre-reform Average Tariff[*]	Average Legal Tariff, 1987	1991 Range	1993 Range	1995 Range
Costa Rica	52	26[a]	10 -50[b]	5 - 30	5 - 20
El Salvador	48	23	5 - 35	5 - 25	5 - 20
Guatemala	50	25	5 - 37[c]	5 - 20	5 - 20
Honduras	41	20	4 - 35[d]	5 - 20	5 - 20
Nicaragua	54	21	5 - 20[e]	5 - 20	5 - 20

SOURCES: "Politicas Industriales en Centroamerica y Panama", ECLAC, LC/MEX/R.310, August 5, 1991; World Bank, Trade Liberalization and Economic Integration in Central America, Report No. 7625-CAM, 1990, p. 29 and 32; Ministry of Economy, Industry and Commerce, Costa Rica.

[*] Ad valorem equivalent of the average external tariff before the reform.
[a] Includes surcharges.
[b] Excludes a temporary surcharge of 2% and a levy of 1% on extra-regional imports. The Central Bank of Costa Rica also requires prior import deposits, currently 30% of the CIF value of the imports.
[c] Excludes a surcharge of 3% on extra-regional imports.
[d] Excludes a general surcharge of 5% and an additional 10% on final products. The surcharges cover all imports, but Central America will be exempt as of 1992.
[e] Excludes a stamp tax of 3% and selective consumption taxes of up to 75% that act as import tariffs. Such taxes will be reduced gradually to 15%.

Table 3

CENTRAL AMERICA: EXPORT PROMOTION SCHEMES

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
FREE TRADE ZONES					
Tax exemptions					
Machinery and intermediate imports	100% [a]	100%	100%	100%	
Profits	100% 8 years 50% 4 years	100% 10 years extendible	100% 12 years	100%	
Local market sales	Up to 40% subject to approval	No limit subject to approval	Up to 20% subject to approval	No limit "when there is not national production of the same", subject to approval	
DRAWBACK INDUSTRIES					
Tax Exemptions					
Machinery and intermediate imports	100%	100%	100%	100%	
Profits	100% [b]	100% 10 years	100% 10 years	100% 10 years	
Local market sales	no	No limit subject to approval	No limit with payment of corresponding taxes	no	
Export Incentives	no	Bonus of 8% of value-added	no	no	
NON-TRADITIONAL EXPORT INCENTIVES					
Tax exemptions					
Machinery and intermediate imports	100%	--	100%	100%	100%
Profits	100% [c]	--	100% 10 years	100% 10 years	80%
Export taxes	--	--	2%	1%	--
Tax Rebates	Up to 12% of the FOB value [d]	--	--	--	15% of the FOB value [e]
Cash Bonus	--	8% of the FOB value	--	--	--
Requirements	35% minimum national value-added	--	--	Generate at least 25 direct jobs	Export at least 25% of production

Source: "Politicas Industriales de Centroamerica y Panama", ECLAC, LC/MEX/R.310, August 5, 1991.

[a] Normally there are no retrictions for imports to the zone, *but raw materials or intermediate imports may be restricted if the Ministry of Industry* determines that local products can meet the price, quality and delivery conditions required by the import firms.
[b] In the case of registered foreign investments, a tax of 15% is charged when repatriating the profits.
[c] In the case of registered foreign investments, a tax of 15% is charged when repatriating the profits.
[d] Declines each year and disappears in 1997.
[e] Declines to 10% in 1993, 5% in 1995 and disappears in 1997.
Note: The figures for Nicaragua are from the proposed "Ley de Promocion de Exportaciones" which has not yet been approved.

Table 4

CENTRAL AMERICA'S EXPORTS BY MAJOR COMMODITY AND MAJOR PARTNER REGIONS

			NORTH AMERICA				OTHER AMERICA		REST OF THE WORLD			
COMMODITY	YEAR	WORLD (1,000 US $)	USA	CANADA	MEXICO	TOTAL	CENTRAL AMERICA	OTHER LATIN AMERICA & CARIBBEAN	EEC 9	JAPAN	OTHER DEVELOPED	OTHER
TOTAL SITC 0 THRU 9(REV.1) SITC 0 THRU 9 -971(REV.2)												
	1965	749495	37.0	0.5	0.0	37.6	17.8	1.3	23.4	14.0	2.3	3.7
	1970	1094187	34.7	0.5	0.2	35.4	26.2	2.3	22.2	7.6	3.4	3.0
	1975	2295653	32.5	0.9	0.9	34.2	23.4	3.8	24.0	7.0	3.2	4.3
	1980	4464982	35.7	0.4	0.6	36.7	25.4	3.4	23.0	3.1	3.3	5.1
	1985	3500527	37.5	1.3	0.6	39.5	15.5	4.6	21.6	5.2	4.0	9.6
	1986	3873284	43.9	1.4	0.4	45.6	10.7	4.8	25.3	5.1	4.0	4.4
	1987	3669902	42.1	1.6	0.4	44.1	14.1	4.6	23.7	3.6	4.6	5.3
DOT	1988	3902420	37.3	3.3	0.9	41.5	14.1	4.2	23.5	4.1	5.4	7.3
DOT	1989	4429069	41.0	3.9	1.2	46.1	14.8	4.7	20.6	3.8	4.8	5.3
DOT	1990	4555327	43.0	3.4	1.4	47.8	14.6	4.5	21.5	3.2	4.1	4.4
FRUITS & NUTS, FRESH & DRIED SITC 051+052(REV.1) SITC 057(REV.2)												
	1965	87427	83.0	0.7	0.0	83.7	1.8	0.5	13.1	0.0	0.6	0.2
	1970	156526	62.1	0.2	0.0	62.3	1.4	0.0	28.4	7.3	0.6	0.0
	1975	232257	70.5	0.1	0.0	70.6	0.9	0.2	26.8	0.1	0.5	0.9
	1980	535107	62.3	0.0	0.0	62.3	3.1	0.4	31.6	0.0	1.3	1.2
	1985	586435	63.2	0.0	0.0	63.2	1.1	0.0	32.1	0.0	1.2	2.4
	1986	627375	63.8	0.0	0.0	63.9	1.3	0.0	30.2	0.1	0.7	3.9
	1987	762725	60.1	0.0	0.0	60.2	1.0	0.0	31.8	0.0	3.9	3.2
BANANAS,PLANTAINS FRESH SITC 0513 (REV.1) SITC 0573 (REV.2)												
	1965	85863	84.1	0.7	0.0	84.9	0.8	0.5	13.0	0.0	0.6	0.2
	1970	154564	62.6	0.2	0.0	62.8	0.9	0.0	28.4	7.4	0.6	0.0
	1975	229144	70.8	0.1	0.0	71.0	0.4	0.2	27.0	0.1	0.5	1.0
	1980	508448	63.3	0.0	0.0	63.3	1.4	0.3	32.4	0.0	1.3	1.3
	1985	563199	63.1	0.0	0.0	63.1	0.5	0.0	32.7	0.0	1.2	2.5
	1986	594493	63.9	0.0	0.0	64.0	0.4	0.0	30.8	0.1	0.7	4.0
	1987	724536	59.5	0.0	0.0	59.5	0.5	0.0	28.1	0.0	1.9	10.0
COFFEE SITC 071												
	1965	283756	50.7	1.0	0.0	51.7	0.2	0.0	40.8	0.7	4.4	2.2
	1970	347279	36.3	1.4	0.0	37.6	0.1	0.0	47.2	1.1	9.2	4.9
	1975	543747	33.3	0.6	0.0	33.9	0.1	0.1	51.5	4.3	8.0	2.0
	1980	1365796	40.7	1.0	0.0	41.8	0.0	0.2	43.0	5.3	7.7	1.9
	1985	1326271	33.7	1.7	0.0	35.4	0.0	0.6	32.7	6.6	8.5	16.0
	1986	1843525	41.6	1.8	0.0	43.4	0.1	0.7	38.6	8.0	7.3	2.0
	1987	1222012	41.0	2.8	0.0	43.8	0.0	0.3	37.3	6.7	7.0	4.8

CENTRAL AMERICA'S EXPORTS BY MAJOR COMMODITY AND MAJOR PARTNER REGIONS

			NORTH AMERICA				OTHER AMERICA		REST OF THE WORLD			
COMMODITY	YEAR	WORLD (1,000 US $)	USA	CANADA	MEXICO	TOTAL	CENTRAL AMERICA	OTHER LATIN AMERICA & CARIBBEAN	EEC 9	JAPAN	OTHER DEVELOPED	OTHER
OTHER FOOD PRODUCTS												
SITC 0-051-052-071+1+22+4(REV.1)												
SITC 0-057-071+1+22+4(REV.2)												
	1965	105247	42.3	0.0	0.0	42.4	38.6	3.3	5.7	9.4	0.3	0.3
	1970	205756	64.6	0.0	0.4	65.1	29.7	0.8	3.3	0.6	0.2	0.2
	1975	597711	55.1	2.2	0.0	57.3	14.8	2.4	19.4	1.1	0.6	4.4
	1980	807021	68.6	0.2	0.3	69.1	20.5	2.3	3.3	1.3	0.4	3.2
	1985	529400	65.8	2.4	2.2	70.3	14.0	4.3	4.2	1.4	0.5	5.4
	1986	576490	56.9	3.1	0.1	60.1	12.2	8.3	4.6	1.8	0.6	12.4
	1987	591646	54.9	3.1	0.1	58.2	16.9	4.6	5.0	1.1	0.6	13.6
OTHER PRIMARY PLUS METALS & MINERALS												
SITC 2-22+68												
	1965	181915	7.8	0.2	0.0	8.0	3.2	1.9	22.7	50.9	1.7	11.6
	1970	141987	11.7	0.1	0.1	11.9	5.0	7.7	18.8	46.6	2.6	7.4
	1975	383395	12.3	0.1	0.9	13.3	4.0	7.0	22.3	34.1	6.3	13.0
	1980	574520	7.9	0.4	1.2	9.6	5.9	2.9	37.9	9.5	5.1	29.1
	1985	372375	9.8	0.5	1.3	11.6	7.2	7.2	26.3	23.0	4.3	20.4
	1986	205250	17.2	0.1	3.0	20.3	9.2	12.7	21.9	19.9	5.0	11.0
	1987	244562	25.6	0.1	5.0	30.7	12.3	10.4	20.2	17.0	3.8	5.6
CLOTHING & TEXTILES												
SITC 65+84												
	1965	23986	0.7	0.0	0.0	0.7	98.6	0.6	0.0	0.0	0.0	0.0
	1970	68092	2.0	0.0	0.1	2.1	96.5	0.8	0.3	0.0	0.1	0.2
	1975	119282	8.0	1.6	0.1	9.6	84.9	1.5	2.5	0.2	0.7	0.6
	1980	259239	5.9	0.1	0.1	6.1	85.7	4.2	3.6	0.1	0.3	0.1
	1985	113486	30.9	1.4	0.1	32.4	55.9	5.9	5.4	0.1	0.1	0.2
	1986	107145	53.2	1.7	0.1	55.0	35.1	6.6	1.9	0.0	0.1	1.4
	1987	146281	55.0	1.8	0.2	57.0	36.5	3.2	3.1	0.0	0.1	0.2
OTHER MANUFACTURES												
SITC 5+6-65-68+7+8-84+9(REV.1)												
SITC 5+6-65-68+7+8-84+9-971(REV.2)												
	1965	63469	3.5	0.1	0.1	3.6	90.6	3.2	0.7	0.0	1.5	0.3
	1970	165895	3.0	0.0	0.5	3.5	89.4	5.3	0.6	0.3	0.2	0.6
	1975	398531	3.5	0.1	4.2	7.8	80.4	8.4	1.1	0.1	0.2	2.0
	1980	867215	8.3	0.1	1.8	10.2	77.1	10.1	2.0	0.1	0.2	0.3
	1985	517638	11.7	1.2	1.2	14.0	68.9	15.5	1.2	0.0	0.2	0.2
	1986	461086	18.2	0.1	1.8	20.1	59.2	18.1	1.3	0.1	0.4	0.8
	1987	545856	18.1	0.4	0.5	19.1	59.1	18.9	1.5	0.1	0.6	0.7

__Source:__ Comtrade data base, United Nations data, International Computing Center, Geneva. 1987 and 1988 data are based on SITC, revision 2. DOT: Direction of Trade Statistics, IMF.

Table 5

CENTRAL AMERICA'S IMPORTS BY MAJOR COMMODITY AND MAJOR PARTNER REGIONS

			NORTH AMERICA				OTHER AMERICA		REST OF THE WORLD			
COMMODITY	YEAR	WORLD (1,000 US $)	USA	CANADA	MEXICO	TOTAL	CENTRAL AMERICA	OTHER LATIN AMERICA & CARIBBEAN	EEC 9	JAPAN	OTHER DEVELOPED	OTHER
TOTAL												
SITC 0 THRU 9(REV.1)												
SITC 0 THRU 9 -971(REV.2)												
	1965	890247	40.4	2.3	1.5	44.2	15.2	6.6	21.8	7.6	3.0	1.6
	1970	1233067	35.5	1.3	2.0	38.8	24.3	5.4	18.7	9.0	2.9	1.0
	1975	2945746	34.6	1.5	2.8	38.9	17.6	15.0	15.6	7.9	3.3	1.7
	1980	6021981	33.0	1.6	3.7	38.3	18.3	20.0	10.7	7.8	3.0	1.9
	1985	5439554	27.0	1.1	13.0	41.1	10.6	17.3	11.3	5.3	4.0	10.4
	1986	4634877	31.7	1.5	6.6	39.7	10.0	14.0	13.3	6.4	4.9	11.7
	1987	5598351	31.2	1.7	6.7	39.6	11.1	12.7	16.8	7.0	5.8	7.0
DOT	1988	5551505	36.8	1.6	6.5	44.9	10.2	12.5	13.9	6.0	4.2	8.3
DOT	1989	6324269	38.4	1.3	6.6	46.4	10.4	12.9	12.6	6.2	4.5	6.9
DOT	1990	6786141	42.0	1.2	5.9	49.0	10.5	12.6	11.4	5.9	3.5	7.2
FOOD												
SITC 0+1+22+4												
	1965	108223	34.7	10.5	1.1	46.3	37.9	1.5	11.5	0.2	1.3	1.3
	1970	140486	35.8	1.6	1.2	38.7	47.3	2.8	9.0	0.3	1.2	0.6
	1975	307269	50.5	1.4	1.0	52.9	30.6	4.7	8.9	0.2	1.6	1.0
	1980	669500	47.3	1.1	0.7	49.1	31.2	6.2	10.4	0.6	2.0	0.5
	1985	561750	48.3	1.6	0.5	50.5	20.8	7.4	12.2	0.3	1.7	7.2
	1986	502803	45.8	2.7	0.6	49.1	17.4	6.2	15.8	0.1	1.7	9.6
	1987	600600	48.3	1.6	2.1	51.9	17.9	6.7	16.6	0.2	4.3	2.3
OTHER PRIMARY PLUS METALS & MINERALS												
SITC 2-22+68												
	1965	18991	39.0	4.6	1.3	44.9	25.6	2.9	14.0	2.9	3.3	6.4
	1970	37238	41.0	3.9	5.1	50.0	22.1	2.8	12.2	7.1	1.1	4.7
	1975	76033	34.7	6.9	5.8	47.4	22.8	5.4	10.5	8.3	3.3	2.3
	1980	181618	43.6	9.2	5.6	58.4	16.6	6.6	7.2	4.8	2.7	3.6
	1985	144750	36.6	5.3	11.2	53.1	15.4	12.1	8.2	1.9	3.0	6.2
	1986	201175	39.6	5.4	7.7	52.7	11.4	9.8	10.4	1.2	2.5	12.1
	1987	255198	30.5	5.6	19.4	55.4	11.4	13.2	9.6	0.8	1.8	7.9
MINERAL FUELS												
SITC 3												
	1965	49363	18.2	0.0	0.2	18.4	7.0	73.3	1.2	0.0	0.0	0.1
	1970	50473	18.3	0.0	0.2	18.5	3.8	76.1	0.7	0.5	0.1	0.3
	1975	369696	4.4	0.0	0.1	4.4	1.7	93.0	0.4	0.1	0.0	0.3
	1980	1132826	4.1	0.0	6.4	10.5	2.0	86.8	0.3	0.1	0.0	0.3
	1985	1479913	7.5	0.0	39.2	46.7	0.6	39.7	0.5	0.1	0.0	12.5
	1986	764600	19.1	0.1	22.7	41.8	0.4	39.3	1.9	0.2	0.1	16.3
	1987	670588	18.9	0.1	19.8	38.8	5.8	49.6	2.6	0.2	0.0	3.0

CENTRAL AMERICA'S IMPORTS BY MAJOR COMMODITY AND MAJOR PARTNER REGIONS

COMMODITY	YEAR	WORLD (1,000 US $)	NORTH AMERICA USA	CANADA	MEXICO	TOTAL	OTHER AMERICA CENTRAL AMERICA	OTHER LATIN AMERICA & CARIBBEAN	REST OF THE WORLD EEC 9	JAPAN	OTHER DEVELOPED	OTHER
CHEMICALS SITC 5												
	1965	149928	42.4	0.9	2.7	46.0	14.1	7.6	28.1	0.6	3.1	0.4
	1970	215465	31.4	0.9	4.0	36.4	24.8	4.6	26.2	3.0	4.2	0.7
	1975	587848	32.4	0.7	5.4	38.5	20.0	5.1	25.5	3.4	5.2	2.3
	1980	1096738	42.0	0.8	5.5	48.3	22.3	4.6	18.0	1.0	5.1	0.8
	1985	1054295	33.3	0.8	4.8	38.9	14.7	8.1	23.3	1.2	8.0	5.7
	1986	998734	33.1	1.2	4.8	39.1	13.3	8.3	23.6	1.7	8.8	5.2
	1987	1146948	32.2	1.9	5.6	39.7	13.4	4.2	26.6	1.6	9.6	5.0
BASIC & MISCELLANEOUS MANUFACTURES SITC 6-68+8+9(REV.1) SITC 6-68+8+9-971(REV.2)												
	1965	308486	36.1	1.6	1.9	39.6	19.4	1.9	19.8	13.5	2.9	3.0
	1970	453293	30.6	1.9	1.7	34.3	33.4	1.9	14.4	11.5	3.1	1.4
	1975	805438	31.6	2.9	2.6	37.2	31.0	2.8	12.9	10.8	2.7	2.7
	1980	1649794	33.9	3.0	2.5	39.4	32.2	3.8	9.7	8.9	2.6	3.5
	1985	1176037	29.9	2.3	3.2	35.4	20.8	11.3	10.2	7.1	4.1	11.1
	1986	1103682	28.2	2.2	4.0	34.5	17.2	11.5	10.4	7.2	5.2	13.9
	1987	1373355	27.8	2.2	5.5	35.5	18.7	10.8	12.0	5.5	5.4	12.0
MACHINERY & EQUIPMENT SITC 7-732 (REV. 1) SITC 7-781-782-783-784 (REV. 2)												
	1965	183964	52.1	0.9	1.1	54.1	2.6	1.4	27.5	8.6	5.1	0.7
	1970	241298	51.8	0.7	1.4	54.0	6.8	1.6	25.0	8.6	3.4	0.7
	1975	601815	52.3	1.1	2.7	56.1	5.3	3.4	22.0	6.6	5.1	1.5
	1980	963460	46.7	1.3	2.6	50.7	6.2	4.0	18.0	12.4	5.8	2.9
	1985	775919	37.3	1.0	2.2	40.4	3.7	7.4	17.8	9.5	7.9	13.4
	1986	765276	39.6	0.7	1.9	42.2	3.1	8.2	16.4	10.1	7.7	12.4
	1987	1112501	35.0	1.6	2.6	39.2	3.0	6.4	26.0	9.2	8.1	8.1
MOTOR VEHICLES SITC 732 (REV.1) SITC 781 THRU 784 (REV2)												
	1965	71291	49.6	0.3	0.2	50.0	0.5	0.3	34.1	12.4	2.4	0.2
	1970	94814	33.1	0.1	0.4	33.5	1.3	0.4	33.0	29.4	2.3	0.1
	1975	197647	30.7	0.4	2.5	33.6	1.4	3.1	17.6	39.8	4.0	0.4
	1980	328045	23.6	0.4	2.4	26.3	0.9	4.8	8.0	55.2	2.0	2.9
	1985	246890	16.9	0.1	1.2	18.3	1.0	6.7	9.2	45.0	4.4	15.4
	1986	298606	23.5	0.2	1.5	25.3	0.8	7.6	8.9	40.3	2.5	14.6
	1987	439160	25.3	0.2	3.1	28.7	0.3	7.6	9.8	43.6	3.9	6.2

Source: Comtrade data base, United Nations data, International Computing Center, Geneva.
1987 data is based on SITC, revision 2.
DOT: Direction of Trade Statistics, IMF.

Table 6

U.S. Imports under CBERA by Duty Treatment and Country
(Value in millions of dollars)

	Costa Rica		Guatemala		El Salvador		Honduras	
	1989	1990	1989	1990	1989	1990	1989	1990
Total Imports	968	1,007	608	791	244	238	458	486
Dutiable Value	200	220	135	194	43	60	55	64
HTS.9802	90	148	38	59	14	19	18	22
Other Dutiable	110	72	97	135	29	41	37	42
Duty Free Value	768	785	476	596	201	177	402	422
MFN	297	261	294	345	131	107	279	269
CBERA	193	218	116	154	28	28	53	68
GSP	90	93	24	38	13	8	20	19
HTS.9802	188	213	42	59	30	33	50	66

Source: USITC, U.S. Department of Commerce.

Note: Totals may not add up due to different data bases.

Table 7

Percentage Share of CACM Exports Facing Non-Tariff Barriers in OECD Markets, 1989 (By Commodity Groups)

	U.S.	E.C.	Japan	Canada
Commodity Groups				
Fruits and Nuts	2.8	3.7	n.a.**	n.a.**
Coffee	0.0	0.0	n.a.	n.a.
Other Food Products	69.2	26.1	n.a.	n.a.
Other Primary incl. Metals & Minerals	11.3	0.5	n.a.	n.a.
Clothing & Textiles	38.0	21.5	n.a.	n.a.
Other Manufactures	5.0	0.4	n.a.	n.a.
All Goods	15.0	2.0	82.3	89.4
of which: Hard Core NTBs *	7.1	1.8	0.9	1.8

* These involve quotas or other quantitative restraints of various kinds, including voluntary export restraints, tariff quotas, reference prices and variable levies.

** Not available.

Source: UNCTAD Data Base on Trade Control Measures.

Table 8

Percentage Share of CACM Exports Facing Non-Tariff Barriers in OECD Markets, 1989 (By Country)

	U.S.	E.C.	Japan	Canada
Costa Rica	26.2	1.2	93.7	98.1
(of which Hard Core NTBs)	(10.9)	(1.1)	(0.1)	(0.4)
El Salvador	7.0	0.2	91.8	98.9
(of which Hard Core NTBs)	(5.2)	(0.1)	(0.0)	(0.1)
Guatemala	11.4	1.4	82.5	99.2
(of which Hard Core NTBs)	(8.1)	(0.8)	(0.0)	(0.5)
Honduras	11.6	5.6	98.3	93.9
(of which Hard Core NTBs)	(1.8)	(5.1)	(2.3)	(0.1)
Nicaragua	2.4	1.5	33.7	43.1
(of which Hard Core NTBs)	(0.0)	(1.5)	(0.2)	(10.1)
All Countries (Weighted Average)	15.0	2.0	82.3	89.4
(of which Hard Core NTBs)	(7.1)	(1.8)	(0.9)	(1.8)

* For a definition, see Table 7 and Footnote 9.

Source: UNCTAD Data Base on Trade Control Measures.

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